

Initial Statement of Reasons
Adoption of Proposed Amendments to
California Code of Regulations, Title 18, Section 1685.5,
Calculation of Estimated Use Tax - Use Tax Table

SPECIFIC PURPOSE AND NECESSITY

Prior Law

Revenue and Taxation Code (RTC) section 6452.1, as enacted by Statutes 2010, chapter 721, section 2, permits taxpayers to make an irrevocable election to report “qualified use tax” on an “acceptable [income] tax return” filed with the Franchise Tax Board (FTB) in order to make it more convenient for taxpayers to comply with their use tax obligations. RTC section 6452.1, subdivision (d)(2), as enacted by Statutes 2010, chapter 721 defined the term “qualified use tax” to mean a taxpayer’s actual unpaid use tax liability after applying the state use taxes imposed under the Sales and Use Tax Law (RTC § 6001 et seq.) and section 35 of article XIII of the California Constitution, and the local and district use taxes imposed in conformity with the Bradley-Burns Uniform Local Sales and Use Tax Law (RTC § 7200 et seq.) or in accordance with the Transactions and Use Tax Law (RTC § 7251 et seq.) to the taxpayer’s purchases of tangible personal property subject to use tax.

Current Law

Senate Bill No. (SB) 86 (Stats. 2011, ch. 14) was enacted on March 23, 2011. It amended RTC section 6452.1 to make it more convenient for taxpayers to comply with their use tax obligations by giving taxpayers the option to report their “estimated use tax liabilities,” based upon their adjusted gross incomes (AGIs) for income tax purposes, for one or more single nonbusiness purchases of individual items of tangible personal property each with a sales price of less than one thousand dollars (\$1000), as determined from a use tax table, instead of calculating and reporting their actual unpaid use tax liabilities (as described above). In addition, RTC section 6452.1, subdivision (d)(2)(A)(i)(II), as amended by SB 86, provides that “the Board shall annually calculate the estimated amount of use tax due according to a person's adjusted gross income and by July 30 of each calendar year make available to [the] Franchise Tax Board such amounts in the form of a use tax table” for inclusion in the instructions to the FTB’s returns and use by eligible taxpayers.

Regulation 1685.5

The Board adopted California Code of Regulations, title 18, section (Regulation) 1685.5, *Calculation of Estimated Use Tax - Use Tax Table*, on July 26, 2011, to prescribe the use tax table that taxpayers may use to estimate their calendar-year 2011 use taxes based

upon their AGIs, prescribe the manner in which the Board shall annually calculate the estimated amount of use tax due according to a person's AGI for calendar year 2012 and subsequent years, and prescribe the format of the use tax tables the Board must make available to the FTB each year. The California Taxpayers Association (CalTax) requested that the Board conduct interested parties meetings to discuss the methodology used to develop the regulation before the Board voted to adopt Regulation 1685.5. The Board's response to this request, as provided in the final statement of reasons for the adoption of Regulation 1685.5, was that:

“[T]he Board did not have adequate time to conduct interested parties meetings before initiating the formal rulemaking process to adopt proposed Regulation 1685.5 because:

- The use tax table provisions were added to RTC section 6452.1 on March 23, 2011;
- The Board needed to adopt a 2011 use tax table and forward it to the FTB for inclusion in the instructions to the FTB's 2011 income tax returns by the July 30, 2011, deadline specified in RTC section 6452.1; and
- The FTB needs to know that the 2011 use tax table adopted by the Board has been approved by OAL by September 1 and will be effective for use with 2011 income tax returns so that the FTB can include the 2011 use tax table in the instructions to its 2011 income tax returns, which will be sent out for publication and incorporation into return preparation software on September 1, 2011.

However, the Board has already scheduled interested parties meetings to discuss whether the Board needs to amend Regulation 1685.5 before the July 30, 2012, deadline, in which it is required to estimate consumers' 2012 use tax liabilities based upon their adjusted gross incomes and prepare a 2012 use tax table for transmission to the FTB.”

Methodology in the Current Regulation

Regulation 1685.5 currently prescribes a methodology for estimating consumers' use tax liabilities based upon their AGI ranges using a “use tax liability factor” determined by:

1. Multiplying the percentage of total personal income spent on electronic and mail order house purchases for the preceding calendar year, as determined from data provided by the United States Bureau of Economic Analysis and the United States Census Bureau, by 37 percent (0.37), which represents the estimated percentage of California consumers' total purchases of tangible personal property for use in California from all out-of-state retailers that are made from out-of-state retailers that are not registered with the Board to collect California use tax from their customers; and
2. Multiplying the product by the weighted average state, local, and district sales and use tax rate, and then rounding the result to the nearest thousandth of a percent.

The format of the use tax table currently prescribed by Regulation 1685.5 allows the majority of consumers to find their AGIs within an established AGI range and read across to the right column to find their estimated use tax liabilities. However, consumers with AGIs over \$199,999 are required to multiply their actual AGIs by the use tax liability factor specified for their AGI range to determine their estimated use tax liabilities. Therefore, the current format of the use tax table prescribed by Regulation 1685.5 eliminates the need for consumers preparing California personal income tax returns reporting AGIs that are \$199,999 or less, regardless of filing status (i.e., single, married, filing jointly, etc.), to perform any mathematical calculations to estimate, report, and pay their eligible use tax liabilities, and greatly simplifies the calculations that consumers with AGIs over \$199,999 are required to make to calculate, report, and pay their eligible use tax liabilities. Furthermore, the current format of the use tax table prescribed by Regulation 1685.5 completely eliminates the need for all eligible consumers to refer to any external sources for additional information, such as the use tax rate, in order to estimate, report, and pay their eligible use tax liabilities.

In addition, data provided by the FTB indicates that 96 percent of California personal income tax returns filed for taxable year 2008, the most recent year for which data is available, reported AGIs of \$200,000 or less. Therefore, the Board believes that the current format of the Board's use tax tables eliminates the need for approximately 96 percent of California consumers who purchased tangible personal property for use in California from unregistered out-of-state retailers to perform additional calculations to estimate their own use tax liabilities.

Interested Parties Comments

Board staff met with interested parties on August 29, 2011, and October 11, 2011, to discuss whether it is necessary to amend Regulation 1685.5 to update the manner in which the Board shall annually calculate the estimated amount of use tax due according to a person's AGI and make such amounts available to the FTB in the form of a use tax table for calendar year 2012 and subsequent years. During the interested parties process, staff received comments indicating that the Board should:

- Clarify the persons who are eligible to use the Board's use tax tables to report their use tax obligations and for what type of purchases;
- Base the "use tax liability factor" for 2012 and subsequent years on the percentage of income spent on "taxable purchases" during the preceding year, rather than the percentage of income spent on "electronic and mail order purchases" for the preceding year; and
- Add more AGI ranges to its use tax tables and narrow the intervals between the AGI ranges so that estimated use tax liabilities increase or decrease by smaller amounts between AGI ranges.

Proposed Amendments

At the conclusion of the interested parties process, Board staff recommended that the Board amend Regulation 1685.5 to:

- Clarify that the Board's use tax tables are optional and may only be used to report estimated use tax for nonbusiness purchases of individual items of tangible personal property each with a sales price of less than \$1,000, as provided in RTC section 6452.1, subdivision (d)(2)(A)(i);
- Provide assurance to consumers that if they correctly report their estimated use tax liabilities for their eligible nonbusiness purchases in accordance with the Board's use tax tables, then the Board may not assess the difference, if any, between the estimated use tax liabilities reported in accordance with the Board's use tax tables and the consumers' actual use tax liabilities, as provided in RTC section 6452.1, subdivision (g);
- Add seven additional AGI ranges to the Board's use tax tables for calendar year 2012 and subsequent years and narrow the intervals between the AGI ranges in the Board's use tax tables so that estimated use tax liabilities increase or decrease by smaller amounts between AGI ranges;
- Move the use tax liability factor calculation date from May 1 to June 1 beginning in calendar year 2012 because the United States Census Bureau typically publishes its electronic shopping and mail order house spending data during May of each year;
- Require the Board to make adjustments to the amount of spending at electronic shopping and mail order houses to arrive at total spending on taxable purchases;
- Require the Board to calculate the percentage of income spent on taxable purchases, rather than the percentage of income spent on all electronic and mail order house purchases; and
- Require the Board to use the percentage of income spent on taxable purchases, rather than the percentage of income spent on all electronic and mail order house purchases, to calculate the use tax liability factors for calendar-year 2012 and subsequent years.

Business Taxes Committee Meeting

During its December 14, 2011, Business Taxes Committee meeting, the Board proposed the adoption of staff's recommended amendments because the Board determined that the amendments are reasonably necessary for the specific purposes of:

- Clarifying the purpose and use of the Board's use tax tables;
- Helping ensure that use taxes due on business purchases are not reported twice;
- Helping ensure that the Board uses the most current United States Census Bureau data possible to calculate the use tax liability factors for 2012 and subsequent years; and
- Improving the overall precision of the Board's estimated amount of use tax due according to a person's AGI range in order to further encourage consumers to use the Board use tax tables.

The proposed amendments are anticipated to provide the following benefits:

- Clarify the purpose and use of the Board's use tax tables;
- Help ensure that use taxes due on business purchases are not reported twice;
- Help ensure that the Board uses the most current United States Census Bureau data possible to calculate the use tax liability factors for 2012 and subsequent years;
- Improve the overall precision of the Board's estimated amount of use tax due according to a person's AGI range; and
- Generally encourage consumers to use the Board use tax tables.

The proposed amendments to Regulation 1685.5 were not mandated by federal law or regulations. There is no previously adopted or amended federal regulation that is identical to Regulation 1685.5.

DOCUMENTS RELIED UPON

The Board relied upon Formal Issue Paper 11-006, the exhibits to the formal issue paper, and comments made during the Board's discussion of the formal issue paper during its December 14, 2011, Business Taxes Committee meeting in deciding to propose the amendments to Regulation 1685.5 described above.

ALTERNATIVES CONSIDERED

The Board considered whether to begin the formal rulemaking process to adopt the proposed amendments to Regulation 1685.5 at this time or, alternatively, whether to take no action at this time. The Board decided to begin the formal rulemaking process to adopt the proposed amendments at this time because the Board determined that the amendments are necessary to update the manner in which the Board shall annually calculate the estimated amount of use tax due according to a person's AGI and make such amounts available to the FTB in the form of a use tax table for calendar year 2012 and subsequent years in order to respond to comments received from interested parties regarding the current provisions of Regulation 1685.5 and generally improve the overall precision of the Board's estimated amount of use tax due according to a person's AGI range.

NO ADVERSE ECONOMIC IMPACT ON BUSINESS

The adoption of the proposed amendments to Regulation 1685.5 will update the manner in which the Board shall annually calculate the estimated amount of use tax due according to a person's AGI and make such amounts available to the FTB in the form of a use tax table for calendar year 2012 and subsequent years in order to respond to interested parties comments and generally improve the overall precision of the Board's estimated amount of use tax due according to a person's AGI range. The proposed amendments will not impose any new taxes or change any exemptions or exclusions. And, the proposed amendments expressly provide that taxpayers are not required to use

the Board's use tax tables to estimate and report their use tax liabilities. Therefore, the Board has made an initial determination that the adoption of the proposed amendments to Regulation 1685.5 will not have a significant adverse economic impact on business.

The proposed regulation may affect small business.

ECONOMIC IMPACT ANALYSIS REQUIRED BY GOVERNMENT CODE
SECTION 11346.3, SUBDIVISION (b)^[BMH1]

The Board has prepared the economic impact analysis required by Government Code section 11346.3, subdivision (b)(1).